

DOE Lessons Learned Template

NOTE: See related Lessons Learned 2005-RF-01

Title: Improvements to contract related to fee schedules-recommendation for fixed quarterly payments

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Lessons Learned Statement: Improvements to Contracts: Fee schedule as written in contract not as efficient as expected

Discussion of Activities:

The contract currently includes a specially written provision, Clause B.6, regarding quarterly fee payments. It can be paraphrased as:

- All quarterly fee payments are conditional. At the end of the contract, the final fee earnings will be calculated. If the total of all quarterly fee payments is less than the contractor has earned, we pay the contractor the difference (the so-called “balloon” payment).
- The standard or “ordinary” fee payment will be about \$6.1M. This is the Target Fee, divided by the total number of quarters in the target performance period, divided by 2.
- The CO will assess the need for adjustments to the ordinary fee payment each quarter. Adjustments will be made based upon performance (i.e., cost or schedule variances from target performance), for safety or safeguards/security violations or negative trends. Clause B.6 includes a rather lengthy discussion of the kinds of things that can result in these fee penalties, and categorizes them into various levels of severity with progressively greater fee reductions for more severe lapses.
- Adjustments for performance do not affect the final fee earnings, only the quarterly payment.
- Adjustments for safety or safeguards/security violations can be either a reduction only in the quarterly payment, or also a permanent deduction from the ultimate fee earnings. (We’ve used both kinds of adjustments, but mostly the permanent kind).

In addition to Clause B.6, the contract includes two very important standard clauses from FAR and DEAR. The FAR clause is required in all cost-plus-incentive-fee contracts (FAR 52.216-10, Incentive Fee). This clause suggests a schedule of fee payments, and authorizes the CO to pay “an appropriate lesser amount” if he/she determines that ongoing contract performance or cost indicates the contractor will not achieve targets. The DEAR clause is the Conditional Payment of Fee clause. RF used an early version of the clause – the current version has a longer title, and can be found

at DEAR 952.204-76. This clause allows fee reductions for safety or safeguards/security violations.

The result of this has been a quarterly process to determine the appropriate fee payment. The process has not been as cumbersome or bureaucratic as an award fee determination, but it still has involved the time and effort of 3 to 7 people each quarter, more at the beginning of the contract, probably about 40 total hours of staff time, and less now near the conclusion of contract scope.

Originally, RF thought was that the quarterly fee payment would become a real-time incentive on its own, without affecting the overall contract fee incentives. At the time RF negotiated this provision, Kaiser was going through severe financial difficulties, and they filed for bankruptcy shortly after contract award. RF thought that Kaiser would be very interested in the cash flow coming thru the quarterly fee payments, and would exert upper management pressure to improve performance and thus increase their quarterly fee payments. (On the other hand, if RF had somehow paid out quarterly fee payments that total more than the contractor has earned, they are required to return any overpayments).

RF now thinks the reality has been somewhat less than expected. First of all, Kaiser's influence over the Kaiser-Hill management essentially disappeared. For all practical purposes, they have been a non-entity at Rocky Flats. Whatever control they once exerted over the management of our project evaporated in the bankruptcy proceedings. CH2M Hill has been in almost total control of the Kaiser-Hill management. Second, even though CH2M Hill and the Kaiser-Hill managers are interested in the amounts of the quarterly fee payments, they seem to be primarily concerned with knowing exactly how much to plan on. The KH team reports to the board of directors, with a projection of the cash flow coming out of the quarterly fee payments.

Recommended Actions:

The suggestion is that the fee payments be established as a fixed amount, with no specially written provisions for adjustments. FAR and DEAR clauses referenced above can be used if there is a need to reduce fee payments to protect the Government's interests. But the important thing is that the fee adjustment process would be conducted on an exception basis rather than as a regular requirement.

Either way, the balloon payment at the end still exists, because the quarterly fee payments should still be established at a conservative number. If the contractor is under-performing under either alternative, the ability to reduce the quarterly fee payments is present. In our current contract, RF uses the B.6 clause, but in the quarterly fee payment alternative the FAR clause would be used as the basis for our reductions.

RF has used current provisions both when the contractor was under-performing and when they got ahead of the curve. For the first six or seven quarters of the contract, KH was reporting negative cost/schedule variances. RF would be making the same

recommendation to go to fixed quarterly payments under either set of performance circumstances.

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